

GOVERNOR'S OFFICE OF
BUDGET AND PROGRAM PLANNING**Fiscal Note 2013 Biennium**

Bill #	SB0190	Title:	Revise income tax - capital gains for held business - estate federal tax ded.
Primary Sponsor:	Essmann, Jeff	Status:	As Introduced

- ☐ Significant Local Gov Impact
 ☐ Needs to be included in HB 2
 ☒ Technical Concerns
- ☐ Included in the Executive Budget
 ☒ Significant Long-Term Impacts
 ☐ Dedicated Revenue Form Attached

FISCAL SUMMARY

	<u>FY 2012 Difference</u>	<u>FY 2013 Difference</u>	<u>FY 2014 Difference</u>	<u>FY 2015 Difference</u>
Expenditures:				
General Fund	\$39,955	\$33,352	\$34,020	\$34,697
Revenue:				
General Fund	(\$13,343,000)	(\$16,059,000)	(\$16,955,000)	(\$17,885,000)
Net Impact-General Fund Balance:	<u>(\$13,382,955)</u>	<u>(\$16,092,352)</u>	<u>(\$16,989,020)</u>	<u>(\$17,919,697)</u>

Description of fiscal impact: Section 1 of this bill makes the limit on the itemized deduction for estates and trusts the same as for individuals. Section 2 provides a credit for capital gains on the sale of certain assets held for over ten years. The net cost to the general fund ranges from \$13 million to \$18 million per year.

FISCAL ANALYSIS**Assumptions:****Federal Income Tax Deduction for Estates and Trusts**

1. This bill would limit the deduction for federal income tax for an estate or trust to \$5,000, beginning with tax year 2011.
2. Tax liability was recalculated for 2007 and 2008 income tax returns of estates and trusts with deductions for federal income tax limited to \$5,000. If this bill had been in effect for those tax years, tax liability for estates and trusts would have been \$0.369 million higher for 2007 and \$1.626 million higher for 2008. This fiscal note assumes that the difference in tax liability in future years would be the average of 2007 and 2008, \$0.998 million.
3. Most estates and trusts affected by this bill would increase their estimated payments to reflect their higher tax liability. This provision would be retroactive to the beginning of tax year 2011. The first half of 2011,

which is in FY 2011, would have passed before these taxpayers could change their payments, so the additional payments for this period would be made in FY 2012. The additional revenue in FY 2012 would be from 1.5 tax years, or \$1.497 million. The increase in revenue for later fiscal years would be \$0.998 million.

4. This bill would require changes to the tax return for fiduciaries and corresponding changes to the department's data processing system. Form changes would be made as part of the annual update process. Data processing changes would require 40 hours of programming and 20 hours of testing. There would be no additional costs, but staff time would be redirected from other projects.

Income Tax Credit

5. Section 2 provides an income tax credit for capital gains on the sale of business assets or stock in a Montana corporation that had been held for at least 10 years. This credit would be in addition to the 2% capital gains credit in current law. Section 2 would be effective beginning with tax year 2011.
6. Taxpayers report total capital gains income on their tax returns. Details on transactions that resulted in capital gains are recorded on federal Schedule D and its supporting schedules. Taxpayers are required to attach copies of these federal schedules to their state returns, but the information on them is not recorded as part of normal return processing. In 2008 through 2010, the Department of Revenue retrieved, recorded, and analyzed a large sample of Schedule Ds attached to returns for tax years 2002 through 2006. Most of the information used to estimate the revenue impact of Section 2 is from this study.

The following two tables show information from the years covered by the study. The first shows capital gains income reported on full year residents' returns in each of the years. Taxpayers calculate total short term and long term capital gains or losses on federal Schedule D. For taxpayers with a net gain or a net loss of \$3,000 or less (\$1,500 for married filing a separate return), this gain or loss is entered on the tax return as capital gains income. For taxpayers with a net loss of more than \$3,000, only \$3,000 of loss is entered on the current tax return and losses of more than \$3,000 must be carried forward to future years.

Capital Gains Income Reported on Returns Short- and Long-Term, Current and Carryover, Subject to Limit on Losses (\$ millions)				
TY 2002	TY 2003	TY 2004	TY 2005	TY 2006
\$637.444	\$790.913	\$1,193.177	\$1,554.054	\$2,006.021

The second table shows estimates of current long-term capital gains for the same years. The first two rows show estimates of gains on the two types of sales that would be eligible for a credit under Section 2. The third row shows estimates of all other gains and the bottom row shows estimates of total current gains. These estimates do not include losses carried forward from previous years and show net gains or losses before the \$3,000 cap on losses is applied.

Estimated Current Long-Term Capital Gains (\$ millions)					
	TY 2002	TY 2003	TY 2004	TY 2005	TY 2006
Corporate Stock	-\$687.009	-\$417.379	\$520.813	\$206.769	\$304.584
Sale or Trade of Business Property	\$606.524	\$563.746	\$868.938	\$732.312	\$929.081
Other	<u>\$291.034</u>	<u>\$289.162</u>	<u>\$547.794</u>	<u>\$842.442</u>	<u>\$1,007.004</u>
Total	\$210.549	\$435.529	\$1,937.544	\$1,781.523	\$2,240.669

7. Regression analysis was used to estimate the relationship between capital gains income in the first table and the components of long-term current gains in the second table. This relationship was then used to estimate the long-term current gains components of the capital gains income assumptions used in the HJR 2 income tax forecast. The first row of the following table shows actual capital gains income for 2009 and the HJR 2 assumptions for 2010 through 2014. The other two rows show the implied long-term gains from the sales of corporate stock and business property.

Forecast Capital Gains (\$ millions)						
	TY 2009	TY 2010	TY 2011	TY 2012	TY 2013	TY 2014
HJR 2 Forecast of Capital Gains Income	\$912.053	\$1,080.320	\$1,436.372	\$1,917.654	\$2,112.009	\$2,313.934
Long Term Gains from Sale of Stock	-\$241.018	-\$123.446	\$125.337	\$461.622	\$597.423	\$738.513
Long Term Gains from Sale of Business Assets	\$663.484	\$703.252	\$787.400	\$901.145	\$947.078	\$994.800

8. The credit for eligible capital gains depends on the number of years each asset was held. The following table shows holding periods and corresponding credit percentages.

Holding Period	10	11	12	13	14	15	16	17	18	19	20	21	22	23	24	25+
Credit %	2.0%	2.2%	2.4%	2.6%	2.8%	3.0%	3.2%	3.4%	3.6%	3.8%	4.0%	4.2%	4.4%	4.6%	4.8%	5.0%

9. The federal capital gains schedules gave valid holding periods for some, but not all, capital gains transactions. The following table shows the percent of transactions with holding periods of at least 10 years and the average credit percentage for those transactions.

	Stock	Business Assets
Transactions with Holding Period 10 Years or More	15.0%	66.7%
Average Credit %	3.1%	4.7%

10. The percentages of capital gains from Montana assets are unknown. Most business property sold by Montana residents is likely to be located in Montana, but most stocks sold by Montana residents are likely to have been issued by companies that are not located in Montana and do not have 60% of their employees in Montana. This fiscal note assumes that 60% of business property sales and 5% of stock sales would be qualifying Montana property.
11. The following tables show the calculation of credits for business property sales and for stock sales and total credits.

Credits for Gains on Business Asset Sales (\$ millions)								
Tax Year	Estimated Gains		% Montana Property		% Held 10+ Years		Average Credit	Credits
2011	\$787.400	x	60%	x	66.7%	x	4.7%	= \$14.811
2012	\$901.145	x	60%	x	66.7%	x	4.7%	= \$16.950
2013	\$947.078	x	60%	x	66.7%	x	4.7%	= \$17.814
2014	\$994.800	x	60%	x	66.7%	x	4.7%	= \$18.712

Credits for Gains on Corporate Stock									
(\$ millions)									
Tax Year	Estimated Gains		% Montana Corps		% Held 10+ Years		Average Credit		Credits
2011	\$125.337	x	5%	x	15%	x	3.1%	=	\$0.029
2012	\$461.622	x	5%	x	15%	x	3.1%	=	\$0.107
2013	\$597.423	x	5%	x	15%	x	3.1%	=	\$0.139
2014	\$738.513	x	5%	x	15%	x	3.1%	=	\$0.172

Total Credits			
(\$ millions)			
TY 2011	TY 2012	TY 2013	TY 2014
\$14.840	\$17.057	\$17.953	\$18.883

12. Some taxpayers would change their estimated payments in anticipation of receiving this credit. Others would not. In either case, payments that are most likely to be changed are estimated payments due in September and January and payments due with returns in April. For each tax year, these payments occur in the next higher numbered fiscal year, so the credits shown for tax years in the preceding table will reduce revenue by the same amounts in FY 2012 through FY 2015.
13. This bill would require an additional form for taxpayers to calculate the credit. The cost to develop the form would be \$3,318 in FY 2012. About 6,000 taxpayers are expected to claim the credit each year. Processing the additional forms would require an additional 0.5 FTE data control technician, starting in FY 2012. Costs to set up a new employee would be \$3,585.
14. There is a 2% per year inflation factor applied to personal services and operating expenses in FY 2014 and FY 2015. Personal services costs would be \$25,972 in FY 2012 and FY 2013, \$26,492 in FY 2014 and \$27,019 in FY 2015. Operating costs would be \$7,080 in FY 2012, \$7,380 in FY 2013, \$7,528 in FY 2014, and \$7,678 in FY 2015.
15. Changes to Form 2 and the instruction booklet would be made as part of the annual update process with no additional costs. Changes to the department's data processing systems would require 276 hours of programming and 100 hours of testing. There would be no additional cost, but department and vendor resources would be diverted from other projects, delaying them. Existing audit staff would be diverted from other tasks to verify credit forms.

	<u>FY 2012 Difference</u>	<u>FY 2013 Difference</u>	<u>FY 2014 Difference</u>	<u>FY 2015 Difference</u>
<u>Fiscal Impact:</u>				
FTE	0.50	0.50	0.50	0.50
<u>Expenditures:</u>				
Personal Services	\$25,972	\$25,972	\$26,492	\$27,019
Operating Expenses	\$10,398	\$7,380	\$7,528	\$7,678
Equipment	\$3,585	\$0	\$0	\$0
TOTAL Expenditures	<u>\$39,955</u>	<u>\$33,352</u>	<u>\$34,020</u>	<u>\$34,697</u>
<u>Funding of Expenditures:</u>				
General Fund (01)	\$39,955	\$33,352	\$34,020	\$34,697
TOTAL Funding of Exp.	<u>\$39,955</u>	<u>\$33,352</u>	<u>\$34,020</u>	<u>\$34,697</u>
<u>Revenues:</u>				
General Fund (01)	(\$13,343,000)	(\$16,059,000)	(\$16,955,000)	(\$17,885,000)
TOTAL Revenues	<u>(\$13,343,000)</u>	<u>(\$16,059,000)</u>	<u>(\$16,955,000)</u>	<u>(\$17,885,000)</u>
<u>Net Impact to Fund Balance (Revenue minus Funding of Expenditures):</u>				
General Fund (01)	(\$13,382,955)	(\$16,092,352)	(\$16,989,020)	(\$17,919,697)

Long-Term Impacts:

1. Due to the volatility of capital gains, the revenue impact of Section 2 of this bill could vary significantly from year to year.

Technical Notes:

1. The terms "Montana business" and "Montana corporation" in Section 2 are not defined.
2. In section 2, new subsection (2)(b) sets the credit at 2% for property held for 10 years or less, while new subsection (2)(c) allows a credit only for property held for at least 10 years. This fiscal note assumes that the intent is to limit the credit to property held for at least 10 years.
3. Section 2 does not specify how gains and credits are to be allocated between spouses when they file a joint federal return and separate state returns. Clarifying this issue for the existing capital gains credit required considerable rule-making. This credit is likely to have additional issues needing clarification. For example, a single transaction could involve property that qualifies for the credit and property that does not.

Sponsor's Initials_____
Date_____
Budget Director's Initials_____
Date